Budget Alert 3.6 Managing the Economy with Fiscal Policy Part 3

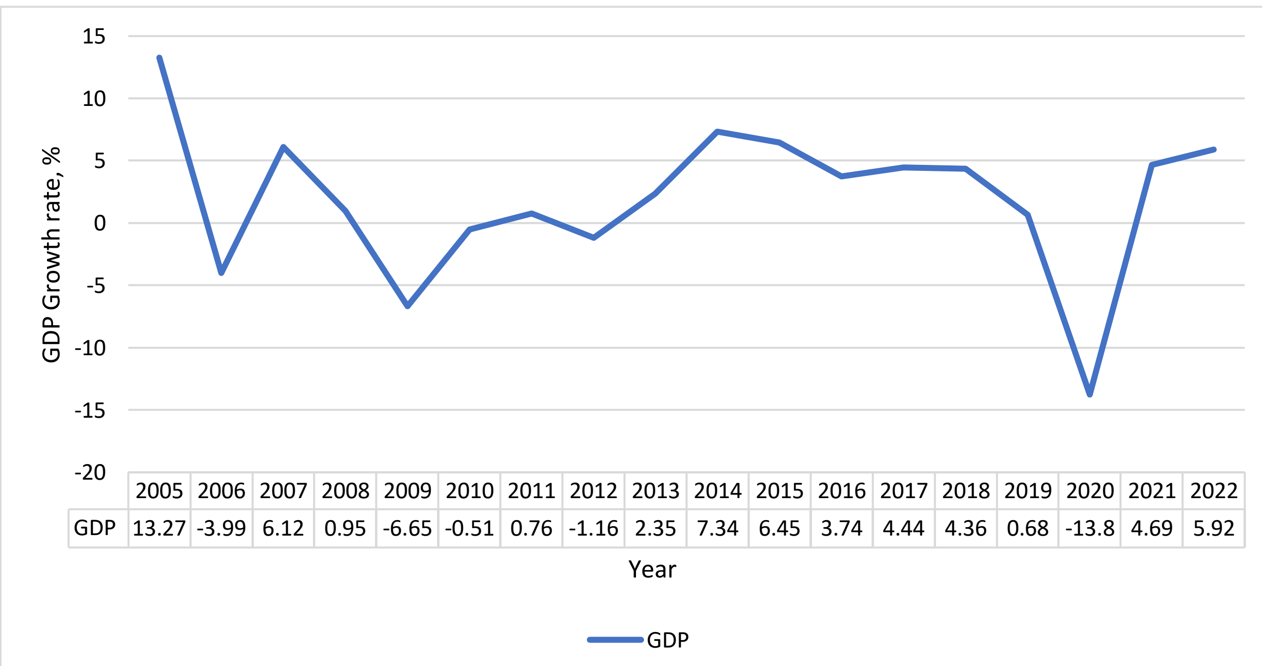
Laurel Theresa Bain

In the management of the economy, there are expected outcomes, foremost of which is the development and transformation of the economy. In the pursuit of fiscal policy, some critical variables are targeted, namely, economic growth and the fair distribution of the associated income, inflation, unemployment, and poverty. While targeting these macro-economic variables, a transformative agenda requires a gradual shift of the structure of the economy and hence, the importance of indicators relating to the contribution of the economic sectors to growth, developments in the social sectors, the source and use of foreign exchange, and the availability of financial resources. Along with the traditional macro and sector indicators for monitoring economic and social activities, it is necessary to establish indicators to measure and monitor developments in emerging sectors such as the creative and digital economy.

Fundamental to achieving the economic and social targets, is the responsibility of the Government to provide public goods and services. These are goods and services that will not be provided by the private sector, as once produced for one person it is difficult to exclude others from benefiting, and society as a whole benefits from the goods and services. The rationale for establishing government is due to its authority to tax and utilize the proceeds for the provision of public goods and services. These are generally related to public administration, the maintenance of law and order, and the provision of other goods and services to ensure a decent standard of living for the population. In undertaking this function, the Government is expected to be efficient in the sourcing and collection of revenues, and to allocate the financial resources efficiently among the competing demands for public goods and services.

The Government, through the use of fiscal policy, is also required to perform the function of stabilizing the economy. In its stabilization role, the Government applies fiscal policy and manages the economy to reduce or eliminate wide fluctuations in national income and employment, that is, periods of booms and depressions. Most countries experience fluctuations in national income and Grenada is no exception. The economy recorded high growth rates, averaging 5.1 percent between 2005 and 2007, stimulated by public and private sector spending in preparation for hosting the World Cup cricket. With the impact of the global financial and economic crisis, the economy contracted, on average, by 3.6 percent between 2009 and 2010. The recovery in the global economy and domestic policies of attracting financial inflows through the Citizenship by Investment programme, reduction in the public debt through debt restructuring and the constraints of the accompanying IMF supported Structural Adjustment Programme, facilitated the availability of financial resources for investment. Consequently, investment by both the public and private sectors expanded and with the revival of the tourism industry, economic growth averaged 5.3 percent between 2014 and 2018. The economy slowed in 2019 and contracted by 13.8 percent in 2020 as a result of the Covid-19 Pandemic. See Chart 1.

Chart 1: Fluctuation in Economic Growth Rates (2005-2022).



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
GDP	13.27	-3.99	6.12	0.95	-6.65	-0.51	0.76	-1.16	2.35	7.34	6.45	3.74	4.44	4.36	0.68	-13.8	4.69	5.92

Source: Eastern Caribbean Central Bank website, June 2023

During the periods of boom, characterized by high and rising national income and employment, the Government fiscal operations should be in surplus, and the Government is expected to accumulate reserves. The sustained growth in national income during periods of boom contributes to higher revenue intake, and if the boom is driven by private sector activities, the Government could moderate its expenditure. While addressing development needs of the country may restrict savings, all efforts should be made to accumulate reserves during periods of high and sustained growth.

During the depression, economic activity is declining, unemployment increases and there is excess capacity in the economy. The Government is expected to stimulate economic activity by injecting funds into the economy through expenditure or increased personal incomes by reducing taxes. The accompanying stagnation in domestic revenue during the depression means that financial resources must be sourced for financing government operations. The first option, in the absence of grants, is to utilize past savings by reducing reserves. Alternatively, governments resort to borrowing during times of depression, thereby aggravating the debt situation. A combination of higher debt and declining GDP results in elevated debt to GDP ratios. This is manifested in the correlation between increased public debt and low and declining economic growth as occurred during the financial and economic crisis and the Covid-19 Pandemic.

The economic cycles of booms and depressions are generally influenced by developments in the international environment. Therefore, the fiscal authorities should be prudent during periods of high and rising national income. The operational fiscal surplus in the periods of boom should be invested in activities that would contribute to sustainable economic growth. The Government should also accumulate reserves for supporting the economy in times of depression. The utilization of the reserves should be weighed more on capital expenditure and less on short-term current spending as these temporary programmes become permanent and unsustainable even during periods of economic growth.

Knowledge is power and experience is the greatest teacher.

Ms. Laurel Bain is a former employee of the Eastern Caribbean Central Bank, where she served for over 25 years. All Budget Alert articles could be obtained from website https://www.innovativealliances.com/.

July 7th, 2023

Disclaimer: This article is written in my personal capacity and not in my capacity as Chairwoman of the Fiscal Responsibility Oversight Committee.